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CIA/OER/S06809-75 THE SOVIET ECONOMY

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Approved For Release 2001/12/05 : CIA-RDP80-00608R000500010007-6

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01 OF 01

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Deputy Director
Approved For Release 2001/12/05 : CIA-RDP86T00608R000600010037-6
Off. of Soviet Union

Affairs
Department of State

JE/P/C
5-6809

Here is the updated version of the briefing on the Soviet economy that you requested.

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Deputy Chief
USSR/Eastern Europe Division

7 Mar 75
(DATE)

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The Soviet Economy

General

-- Soviet economic growth slowed markedly in 1974 because of a 3 percent dip in agricultural output. GNP increased by 3.2 percent compared with a 7.5 percent growth in 1973. Nevertheless, Soviet growth compared favorably with that in the recession-hit West.

-- The Soviets are clearly shifting to a more balanced approach to economic growth. Consumption has been placed on a more equal footing with investment among competing uses for output, and a larger share of investment resources is being devoted to consumer related sectors such as agriculture.

-- Soviet trade with the West increased by almost 43 percent last year, compared with a 60 percent increase in 1973. In contrast to the general increase, agricultural imports were cut back. Moscow's ability to import technology and equipment has been strengthened by a major turnabout in its hard currency position; price increases for Soviet oil and other raw materials have far outweighed price increases for imports.

Agriculture

-- Unfavorable weather conditions last year resulted in a Soviet grain crop of 195.6 million tons, short of the plan target of 206 million tons and much less than

1973's record harvest of 222.5 million tons. Nevertheless, it was the second largest crop in Soviet history.

-- Grain production was 5-10 million tons short of domestic requirements and export commitments. Soviet leaders had the option of reducing reserves built up after the 1973 harvest or importing foreign grain. They apparently chose to leave the stocks largely untouched and contracted to import almost 7 million tons of grain for delivery in Fiscal Year 1975.

The agricultural sector is by far the weakest and least productive sector of the Soviet economy.

-- The system of collective and state farms has proved to be the worst managed and least efficient organizational form in the country.

-- Not only is the agricultural sector hard pressed to increase the supply of food in pace with the needs of a modernizing and moderately growing population, but it ties down a very large percentage of the labor force.

Forty million people, about 27 percent of its labor force, is engaged in meeting the nation's food requirements. In the US only 5 percent of the labor force is on the farm.

-- Productivity of labor is much higher in the US, partly because the US farmer uses mineral fertilizers much more intensively, and the ratio of farm equipment to cultivated acreage is far higher in the US. For example, one farm laborer in the USSR feeds seven people; in the US, one farm laborer feeds 48.

-- In recognition of the serious problems in Soviet agriculture, we expect continued high priority accorded to this sector, with increased deliveries of equipment and fertilizer, extensive land reclamation programs, and the development of the recently announced Brezhnev plan to improve agricultural land in the northern European areas, the so-called non-black-soil zone. The entire program is clearly designed to reduce the large fluctuations in farm output -- particularly grain -- which have plagued Soviet agriculture.

Industry

Industrial output grew by an estimated 6.8 percent in 1974 -- the largest annual increase since 1970. Adequate supplies of raw materials and energy were major factors in this growth as well as larger than planned additions of new workers and the highest rise in labor productivity in the five-year plan period. The leading industrial sectors -- energy, producer durables, chemicals and processed foods --

reflect the leadership's priority for technological growth and expansion of agricultural output.

From a longer-run perspective Soviet industry faces a diminishing supply of those inputs of capital and labor which in the past have been the main contributors to high growth rates, slow progress in the application of modern technology, a low level of productivity, and concern that the technological gap vis a vis the West may in fact be widening.

-- If the growth record of the Soviet Union is compared to the principal market economies, a striking feature is the particular dependence of the USSR on rapid additions to its active labor force and to its productive plant and equipment, as distinguished from its ability to use its basic productive resources efficiently. In other words, past high rates of growth could be sustained mainly by stepping up inputs of labor and capital.

-- However, in recent years, there has been a marked slowdown in the pace at which new modern plant and equipment were introduced. Much of the disappointing performance, in turn, stems from inferior and outdated technology.

-- The need therefore is for a qualitative improvement, a more efficient use of the labor and capital available. With a volume of industrial output almost two

thirds that of the US, industrial labor productivity in the USSR is roughly 40 percent that in the US and this comparison, moreover, does not take into account the substantially poorer quality of most Soviet products.

-- The burden of maintaining a military establishment roughly equal to that of the US falls heavily on Soviet industry. The defense program diverts industrial output from investment programs, preempts the services of the best managerial, scientific and engineering manpower, and orients Soviet R and D programs heavily toward military objectives.

-- To help boost productivity, the regime, while continuing to tinker with organizational and managerial reforms, is relying increasingly on foreign contacts, particularly with the West. It believes that the shortcut to technological progress and accelerated growth in productivity lies in improving western machinery and technology.

Consumer Welfare

It has been the Soviet consumer who has paid the price for the high priority accorded by Soviet leaders to defense needs and providing for rapid industrial growth. His per capita consumption is only one-third that of the average US citizen.

-- Material conditions have been improving and now that the demand for many basic consumer items has been satisfied, growing emphasis is being placed on catering to consumer demand for improved quality and variety.

-- The area in which unsatisfied demand is the greatest -- housing -- has been among the slowest to improve.

- although the USSR has built urban housing at a very rapid rate during the last decade, housing space per capita is only about one-third that in the US and half that in West Germany. Even if the five year plan housing goal is reached, it would still leave per capita housing space about 10 percent short of the minimum standards set for health and decency by Soviet officials.

-- The Soviet Government has shown increasing sensitivity to the needs of the consumer. While it is still premature to speak of "consumer sovereignty" in the USSR, recent improvements in consumer welfare have whetted the appetite for further gains. And the visible satisfaction of rising expectations elsewhere will be noted increasingly in the USSR, stimulating pressures from technocrats for advanced productivity methods and demands from consumers for more and better goods and services.

-- In this connection, the Soviets are looking increasingly to the Western countries for modern equipment and technology to produce consumer goods.

US-Soviet Trade

US-Soviet trade has developed rapidly since the trade agreement and the lend lease accord were concluded in 1972. Bilateral trade totalled a record \$1.4 billion in 1973 and almost \$1 billion in 1974, the drop attributable to smaller grain imports. Moscow's renunciation of the 1972 trade agreement should not substantially affect the volume of US-Soviet trade in 1975. US exports are expected to exceed the 1974 level because of deliveries of capital goods ordered by the USSR in 1972-73 when Eximbank credits were available. In the long-term, US-Soviet economic relations will depend on overall progress in detente and on the extent to which recent US legislative restrictions are modified.

In assessing the potential for US-Soviet trade, several factors must be borne in mind.

(1) -- Even at the record level of 1973, US-Soviet trade accounted for only 3.3 percent of all Soviet foreign trade and imports from the US represented less than two-tenths of one percent of the Soviet GNP. Conversely, US-Soviet trade in 1973 amounted to 1.0 percent of our total trade and less than one-tenth of one percent of our GNP.

(2) -- Although the historic doctrine of autarky has

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found a dwindling number of adherents in the USSR, Soviet leaders may not yet have come to the point of accepting international economic cooperation with the US or the West as an unqualified good, either on economic or political grounds.

(3) -- The Soviet trade profile with the US and the West in general -- reflecting a pattern of machinery and equipment imports and raw materials exports -- more nearly resembles that of a less developed country than an economy second in size only to that of the US. And the Soviet export pattern does not yet show any indication of the diversity of exports which is a prerequisite for any substantial expansion of trade with the West.

(4) -- Soviet trade with Eastern Europe has accounted for about half of total Soviet foreign trade and the economics -- and politics -- of this trade pattern is not likely to change in the short run.

(5) -- While it can be argued that the Soviets stand to gain technologically from expanded commercial relations with us than the quantitative data on trade volume would suggest, this too should not be over-emphasized. Imports of plant and equipment from the US, even under the most optimistic assumptions, will constitute only a fraction of the total value of equipment invested in Soviet industry

and these will be operated in the Soviet institutional milieu with all its endemic inhibitions to the rapid diffusion and utilization of even domestically generated technology. Perhaps the most that can be said is that US technology will raise technological levels in certain key sectors of the Soviet economy, but the barriers to rapid assimilation will ensure that the overall diffusion of foreign technology in the USSR will be slow and uneven.

-- Finally, although the current Soviet BOP position is better than it has been in decades -- thanks to augmented hard currency earnings from higher prices for its oil and gold exports -- much of the projected growth in trade with the West will be credit financed. Soviet hard-currency indebtedness grew to about \$4.2 billion last year and debt service payments of about \$1.1 billion represented about 15 percent of its hard currency exports. Credits have to be repaid and the level of Soviet indebtedness will exert a constraint on Soviet import capabilities.

-- In sum, I think the Secretary was perfectly correct when he told the Senate Foreign Relations Committee that while economic relations with the USSR cannot be separated from the political context, a sense of proportion must be maintained about the leverage our economic relations give us with the USSR.

Trade with the Soviet Military

-- Imports of Western machinery and equipment are only a small share of total Soviet investment in plant and equipment and therefore will not provide a significant growth dividend.

-- Furthermore, to fill military requirements from resources freed from civilian industry would be a reversal of traditional resource allocation policy. Generous allocations have been made to military programs regardless of shortages elsewhere in the economy.

-- The problem is that practically all sophisticated technology - whether in the area of automotive technology, electronics, electronic instruments, metallurgy or in other areas - have some potential application in military production.

-- Given our export controls, however, the exports of even these goods do not mean that military refinements to these technologies would be transferred to the USSR along with the basic civilian technology.

Oil and Natural Gas

Oil

-- The USSR is a net exporter of oil.

-- The USSR is less affected by the energy crisis than any of the other industrialized nations.

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-- The Eastern European countries overall get about 75-80 percent of their imported oil from the USSR. They pay less than the world market price even though the Soviets recently more than doubled the price.

-- After supplying EE, the USSR has left about nine percent of its production for Western Europe and Japan. This oil is sold at world market prices.

-- The USSR faces problems in increasing oil production. Present production is at the rate of 600,000 barrels a day. Up to 1980, Soviet oil production is expected to increase from the present level of nine million barrels a day to about 11.7 million barrels a day.

-- Soviet domestic consumption is rising at the rate of about 6%-7% a year but is expected to taper off to about 15% a year during 1976-80.

-- In setting future oil export policy, the USSR must draw a balance between maintaining its political influence in Eastern Europe and earning more foreign exchange from sales in Western Europe.

Natural Gas

-- The USSR is looking to natural gas to take up the slack as oil production tapers off. They are concentrating on gas development. A contract with West

Germany provides for delivery of 900,000 tons of pipe. This contract would give the Soviets an additional 70 billion cubic feet of gas a year for 22 years.

-- Even if the North Star project falls through, the USSR will build a pipeline on its own from that area.

-- Soviet supply of natural gas to western Europe now is proportionately small, but by 1980 it could amount to 10 percent of total supply in West Germany and Italy.